

TOWN OF BROOKLINE

FISCAL POLICY REVIEW COMMITTEE

FINAL REPORT



January 2004

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FISCAL POLICY REVIEW COMMITTEE

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INTRODUCTION

We want to thank the Board of Selectmen for the opportunity to become so deeply involved in the fiscal policies of our Town. For a number of us, this was our first venture into the workings of our Town government. While some Committee members had previous involvement with the Town's budgeting practices, we all emerged from this experience impressed with the Town's commitment to financial management and the professionalism with which it is carried out. As one financial expert who met with us noted, the Town of Brookline is in an "enviable" financial position compared to most other municipalities, in large part due to its financial practices.

In our public hearing, the Committee was asked what kind of predisposition we brought to our work. We hope it is fair to say that our collective outlook on fiscal policies and practices is as varied as the spectrum that might be found throughout the community. We brought public, private, and non-profit perspectives to the table. Members of this Committee have held senior executive positions in federal, state, and local government. We have backgrounds that run the gamut from general management to accounting and finance. In the end, we are all committed to making Brookline an even better place for our families, our local businesses, and all our fellow taxpayers.

We believe that our efforts will assist Town decision-makers, both elected and appointed, in meeting the very difficult challenges that are ahead. The Town has had sound fiscal policies in place for the past decade. We are hopeful that our recommendations will not only update them, but also adapt them more specifically to the conditions the Town has begun to experience in this first decade of the 21st century.

Charge to the Committee

At our first meeting on September 12, 2003, the Chairperson of the Board of Selectmen personally delivered the following straightforward charge to the Committee:

**“To assess and make recommendations in regard
to Town practices for funding reserves
and funding capital improvements”.**

Before elaborating on our approach to this ostensibly simple-sounding charge, it is important to understand what it does not entail. The Committee was not given a mandate to review the general quality of Town services. (Although in any project such as this, an evaluative eye is always cast on the performance of the organization behind the task at hand.) Also, the Committee was not directed to assess the nature of the Town's tax burden or its relative standing to other cities and town for overall revenues and expenditures. (The Committee was provided with *Volumes I and II* of the *2003 Financial Trend Monitoring Report* to provide contextual information.) And perhaps most significantly, the Committee clearly understood that it was not being asked to gauge the need for a Proposition 2 ½ Override. The Selectmen were emphatic

about this and made it quite clear as early as the interview process, well before eventual Committee members were actually appointed.

On the other hand, Committee members individually and collectively understand that Fiscal Policies cannot be reviewed clinically in isolation from the issues that underlie the overall content of the Town's Annual Financial Plan. Further, the Committee recognizes that financial needs and practices of a community are *not* like that of a private company. Our community's capacity to raise revenues, and the services it must provide, are in large measure circumscribed by statute.

Unlike a company, Brookline will always be here and have ongoing associated commitments and obligations. While the guidelines embodied in Town fiscal policies are not etched in stone, they are a serious and necessary component of good and responsible financial planning for our community. Throughout its work, the Committee remained acutely aware that decisions concerning reserve levels and capital expenditures can have a profound effect on the operating budget in both the short and long term.

Approach

Without losing sight of the overall budgetary context, the Committee nevertheless undertook its specifically defined mandate literally in order to conduct as thorough an examination as possible of Town policies and practices regarding reserve funds and capital budgeting. Six separate reserve funds were examined¹:

- Appropriated Budget Reserve
- Non-Appropriated Budget Reserve
- Capital Stabilization Fund
- Liability/Catastrophe Fund
- Post-Retirement Benefits Trust Fund
- Overlay Reserve

The history of establishing each of these reserves and their current balances were analyzed. Ten-year funding and expenditure histories were reviewed. In addition, the Town's use of these reserves was matched against the practices of comparable communities.

A similar methodology was used in our examination of Capital Policies. Each policy was reviewed individually. Aggregate capital expenditures spanning the past decade were analyzed by classification of projects. CIP authorizations totaling more than \$210 million were classified in nine separate categories to better understand how the Town implements its CIP in relation to stated policies. Here, too, Brookline was evaluated against other municipalities in terms of

¹ Three other areas involving the setting aside of funds for long-term unfunded obligations were also considered: the Retirement Fund, Group Health Trust Fund, and Workers Compensation Trust Fund. These were not examined in detail because the Town has less discretionary control due to statutory prescriptions and/or fixed cost requirements. In addition, the Overlay Reserve is set by statute and the Board of Assessors.

formulation and adherence to policies, along with comparison of specific indicators such as debt burden.

In the course of our review, we also addressed policies related to Free Cash. For the most part, our task was to reorganize them to reflect, in a more coherent fashion, the guidelines embedded in the reserve and capital policies.

The Committee met twelve times between September 12, 2003 and January 16, 2004, with meetings posted in accordance with the Open Meeting Law. Member attendance was excellent from beginning to end.

The format of the Committee's meetings included review of data, discussion and debate. On several occasions the Committee invited guests to present information on relevant topics. One such meeting centered on a discussion with external experts on municipal finance. Samuel Tyler, President of the Boston Municipal Research Bureau, and Philip Shapiro, Managing Director of the Boston Office of Standard and Poor's, provided the Committee with a perspective on best practices and trends in municipal finance.

Another session was a public hearing to solicit citizen perspective. Notice of the public hearing was formally published and posted on the Town website, along with being mailed to all Town Meeting Members and noted in the newspaper. We appreciate the willingness of those who attended to take the time to express their opinions. It should also be noted that one meeting was devoted to the fiscal policies as they relate to the Schools, given that Schools account for such a significant portion of the operating and capital budgets. The Chair of the School Committee and two other members participated.

At the outset of the Committee's work, general understanding of the Town's financial condition was ascertained from several sources. The Committee was provided with the Annual Financial Plan, the most recent audit report and bond prospectus, as well as *Volumes I and II* of the *Financial Trend Monitoring Report*. The Committee never lacked accurate or comprehensive data, as the appendices to this Report attest. Members were continually impressed with the Administration's ability to generate the information needed to carry out our work, often providing it even before requested to do so.

Because of the continuously evolving fiscal environment within which the Town must function, we do recommend that the Board of Selectmen reconvene this Committee or convene a successor committee in three to five years to revisit the policies at that time. For policies to maintain their viability over the long term, they too must evolve with the circumstances they are intended to address. Indeed, only time will affirm the extent to which our own recommendations are effective. Meanwhile, based on past experience, the Committee has every confidence that the Board of Selectmen, Advisory Committee, and Town Administration will continue to apply the policies in their recommendations to Town Meeting. The principles underlying the policies are critical to the fiscal well being of any large, complex enterprise.

THE PROPOSED POLICIES

The Town of Brookline already has a well-established set of effective fiscal policies. The fact that formal policies exist is quite encouraging. Perhaps more importantly, the Town appears to have followed the policies. Survey data suggests that among the few communities that have adopted such policies, most have had difficulty implementing and/or adhering to them.

The Committee would like to acknowledge the work of our predecessor committees—the Financial Planning Advisory Committee (1994) and the Capital Review Committee (1997) in laying the groundwork for these policies, as well as the ongoing efforts of the Board of Selectmen, Advisory Committee, Administration, and staff in following these policies.

The Committee's substantive recommendations are embodied in a complete reformatting of the proposed policy documents themselves. We urge this change in presentation to simplify understanding of the policies that have been adopted over time and are recorded in various Selectmen votes, separate reports, and staff memoranda. The consolidated fiscal policies, which appear on the following pages, should be printed each year in the Annual Financial Plan.

Proposed
TOWN OF BROOKLINE
RESERVE POLICIES

The Town shall maintain the following general, special, and strategic reserve funds:

Budget Reserve – to respond to extraordinary and unforeseen financial obligations, an annual budget reserve shall be established. The funding level shall be an amount equivalent to 1% of the prior year's net revenue, maintained in the manner set out below. Any unexpended balance at the end of the fiscal year must go toward the calculation of free cash; no fund balance is maintained.

Appropriated Budget Reserve – an amount equivalent to .75% of the prior year's net revenue shall be allocated to an Appropriated Budget Reserve, as allowed for under MGL Chapter 40, Section 6. Funding shall come from the tax levy.

Non-Appropriated Budget Reserve – an amount equivalent to 0.25% of the prior year's net revenue shall be allocated for use as an emergency reserve. It shall only be utilized if the Town's Appropriated Budget Reserve is depleted. Funding shall come exclusively from Free Cash, per the Town's Free Cash Policies.

Stabilization Fund – a Stabilization Fund shall be maintained, under the provisions of MGL Chapter 40, Section 5B.

1. The target funding level for the Fund shall be an amount equivalent to 3% of the Town's prior year's net revenue, as defined in the CIP policies. The Fund shall be funded only with Free Cash or one-time revenues.
2. The Stabilization Fund may only be used under the following circumstances:
 - a. to fund capital projects, on a pay-as-you-go basis, when available Free Cash drops below \$2 million in any year; and/or
 - b. to support the operating budget when Net Revenue, as defined in the CIP policies, increases less than 3% from the prior fiscal year.
3. The level of use of the Stabilization Fund shall be limited to the following:
 - a. when funding capital projects, on a pay-as-you-go basis under #2a. above, no more than \$1 million may be drawn down from the fund in any fiscal year. The maximum draw down over any three-year period shall not exceed \$2.5 million.
 - b. when supporting the operating budget under #2b. above, the amount drawn down from the fund shall be equal to the amount necessary to bring the year-over-year increase in the Town's prior year net revenue to 3%, or \$1 million, whichever is less. The maximum draw down over any three-year period shall not exceed \$2.5 million.

4. In order to replenish the Stabilization Fund if used, in the year immediately following any draw down, an amount at least equivalent to the draw down shall be deposited into the fund. Said funding shall come from Free Cash.

Liability / Catastrophe Fund – established by Chapter 66 of the Acts of 1998, and amended by Chapter 137 of the Acts of 2001, this fund shall be maintained in order to protect the community against major facility disaster and/or a substantial negative financial impact of litigation. The uses of and procedures for accessing the fund are prescribed in the above referenced special act. The target fund balance is 1% of the prior year's net revenue and funding shall come from available Free Cash and other one-time revenues.

Post-Retirement Benefits Trust Fund – established by Chapter 472 of the Acts of 1998, this fund shall be maintained to offset the anticipated costs of post-retirement benefits of retired employees. The uses of and procedures for accessing the fund are prescribed in the above referenced special act.

The balance in the Fund shall be maintained, but future funding shall be suspended until a comprehensive statewide municipal approach is adopted. When funding is re-activated, funding may come from continued decreases in other fringe benefit line-items; from continued year-end surpluses in appropriations for employee health insurance; from continued assessments on the non-General Funds that support benefit-eligible employees; and Free Cash and other one-time revenues.

Overlay Reserve – established per the requirements of MGL Chapter 59, Section 25, and the Overlay is used as a reserve, under the direction of the Board of Assessors, to fund property tax exemptions and abatements resulting from adjustments in valuation. The Board of Selectmen shall, at the conclusion of each fiscal year, require the Board of Assessors to submit an update of the Overlay reserve for each fiscal year, including, but not limited to, the current balances, amounts of potential abatements, and any transfers between accounts. If the balance of any fiscal year overlay exceeds the amount of potential abatements, the Board of Selectmen may request the Board of Assessors to declare those balances surplus, for use in the Town's Capital Improvement Plan (CIP) or for any other one-time expense.

Proposed
TOWN OF BROOKLINE
FREE CASH POLICIES

After funding the Town's reserves, as detailed in the Town's Reserve Policies and summarized below, available Free Cash shall be used exclusively to supplement the Capital Improvements Program (CIP).

FREE CASH FOR RESERVES

Non-Appropriated Budget Reserve – an amount equivalent to 0.25% of the prior year's net revenue shall be set aside for use as an emergency reserve. It shall only be utilized if the Town's Appropriated Budget Reserve Fund, as allowed for under MGL Chapter 40, Section 6, is depleted.

Stabilization Fund – Free Cash shall be used to fund the Stabilization Fund at a level equivalent to 3% of the prior year's net revenue, as prescribed in the Town's Reserve Policies. If the Fund were drawn down in the immediate prior fiscal year, then an allocation shall be made to the Fund in an amount at least equivalent to the draw down of the immediate prior fiscal year.

Liability / Catastrophe Fund – to the extent necessary, Free Cash shall be used to reach the funding target of the Town's Liability / Catastrophe Fund, as outlined in the Town's Reserve Policies.

Affordable Housing Trust Fund – in order to support the Town's efforts toward creating and maintaining affordable housing, Free Cash shall be appropriated into the Affordable Housing Trust Fund according to the following schedule:

- when Free Cash exceeds \$6 million, 5% shall be allocated to the Affordable Housing Trust Fund.
- when Free Cash exceeds \$7.5 million, 7.5% shall be allocated to the Affordable Housing Trust Fund.
- when Free Cash exceeds \$10 million, 10% shall be allocated to the Affordable Housing Trust Fund.

Special Use – Free Cash may be used to augment the trust funds related to fringe benefits and unfunded liabilities related to employee benefits.

FREE CASH FOR CAPITAL

After providing for the reserves and the Affordable Housing Trust Fund as stated above, 100% of any remaining Free Cash balance shall be dedicated to the Capital Improvement Program (CIP).

Proposed
TOWN OF BROOKLINE
CAPITAL IMPROVEMENT PROGRAM (CIP) POLICIES

Definition of a CIP Project

A capital improvement project is any project that improves or adds to the Town's infrastructure, has a substantial useful life, and costs \$25,000 or more, regardless of funding source. Examples of capital projects include the following:

- Construction of new buildings
- Major renovation of or additions to existing buildings
- Land acquisition or major land improvements
- Street reconstruction and resurfacing
- Sanitary sewer and storm drain construction and rehabilitation
- Water system construction and rehabilitation
- Major equipment acquisition and refurbishment
- Planning, feasibility studies, and design for potential capital projects

Evaluation of CIP Projects

The capital improvement program shall include those projects that will preserve and provide, in the most efficient manner, the infrastructure necessary to achieve the highest level of public services and quality of life possible within the available financial resources.

Only those projects that have gone through the CIP review process shall be included in the CIP. The CIP shall be developed in concert with the operating budget and shall be in conformance with the Board's CIP financing policy. No project, regardless of the funding source, shall be included in the CIP unless it meets an identified capital need of the Town and is in conformance with this policy.

Capital improvement projects shall be thoroughly evaluated and prioritized using the criteria set forth below. Priority will be given to projects that preserve essential infrastructure. Expansion of the capital plan (buildings, facilities, and equipment) must be necessary to meet a critical service. Consideration shall be given to the distributional effects of a project and the qualitative impact on services, as well as the level of disruption and inconvenience.

The evaluation criteria shall include the following:

- Eliminates a proven or obvious hazard to public health and safety
- Required by legislation or action of other governmental jurisdictions
- Supports adopted plans, goals, objectives, and policies
- Reduces or stabilizes operating costs

- Prolongs the functional life of a capital asset of the Town by five years or more
- Replaces a clearly obsolete facility or maintains and makes better use of an existing facility
- Prevents a substantial reduction in an existing standard of service
- Directly benefits the Town's economic base by increasing property values
- Provides new programs having social, cultural, historic, environmental, economic, or aesthetic value
- Utilizes outside financing sources such as grants

CIP Financing Policies

An important commitment is to providing the funds necessary to fully address the Town's capital improvement needs in a fiscally prudent manner. It is recognized that a balance must be maintained between operating and capital budgets so as to meet the needs of both to the maximum extent possible.

For the purposes of these policies, the following definitions apply:

Net Operating Revenue - Gross revenues, less net debt exclusion funds, enterprise (self-supporting) operations funds, free cash, grants, transfers from other non-recurring non-general funds, and non-appropriated costs.

Net Direct Debt (and Debt Service) - Gross costs from local debt, less Prop 2 1/2 debt exclusion amounts and amounts from enterprise operations.

Net Tax-Financed CIP - Gross amount of appropriations for capital improvements from current revenues, less amounts for enterprise operations, grants, free cash, transfers, and non-recurring special revenue funds.

The capital improvements program shall be prepared and financed in accordance with the following policies:

OUTSIDE FUNDING

State and/or federal grant funding shall be pursued and used to finance the capital budget wherever possible.

ENTERPRISE OPERATIONS - SELF SUPPORTING

Capital projects for enterprise operations shall be financed from enterprise revenues solely.

CIP BUDGET ALLOCATIONS - 5.5% OF NET REVENUES

Total net direct debt service and net tax-financed CIP shall be maintained at a level equivalent to 5.5% of prior year net operating revenues.

TAX FINANCED ALLOCATION - 1.25% OF NET REVENUES

Net tax-financed capital expenditures shall be maintained at a target level equivalent to 1.25% of prior year net operating revenues.

DEBT-FINANCED ALLOCATION - 4.25% OF NET REVENUES

Net direct debt service shall be maintained at a target equivalent to 4.25% of prior year net operating revenues.

DEBT MANAGEMENT POLICIES

Debt financing of capital projects shall be utilized in accordance with the following policies:

Debt financing shall be reserved for capital projects and expenditures which either cost in excess of \$100,000 or have an anticipated life span of five years or more, or are expected to prolong the useful life of a capital asset by five years or more.

Bond maturities shall not exceed the anticipated useful life of the capital project being financed. Except for major buildings and water and sewer projects, bond maturities shall be limited to no more than ten years.

Bond maturities shall be maintained so that at least 60% of the outstanding net direct debt (principal) shall mature within 10 years.

Total outstanding general obligation debt shall not exceed 2.5% of the total assessed value of property.

Total outstanding general obligation debt per capita shall not exceed \$2,000. Beginning on July 1, 2004, the \$2,000 per capita shall be adjusted annually by the consumer price index (CPI) for all urban consumers (northeast region all items).

Total outstanding general obligation debt per capita shall not exceed 6% of per capita income, as defined by the Census Bureau of the U.S. Department of Commerce.

FREE CASH

After using free cash in accordance with the Town's free cash policy, available free cash shall be used exclusively to supplement the capital improvements program.

FINDINGS AND RECOMMENDATIONS

Reserves

Reserves provide a measure of financial security and flexibility to a local government. Maintaining adequate reserves is a crucial component of fiscal stability and indicates a community's ability to guard against cyclical downturns and unexpected expenditures. At our session with municipal finance experts, Phil Shapiro confirmed that rating agencies carefully monitor reserve levels and use them in evaluating a government's fiscal stability when assigning a bond rating. A high bond rating indicates a community's ability to repay debt, which translates into savings on interest costs when a community borrows money on the capital markets.

Generally, the Committee found that Town reserves are within the norm as practiced in comparable communities and as recommended by public finance authorities. Sam Tyler suggested a range of 5% to 10% in combined reserves for the operating budget, stabilization, liability, and Overlay. Brookline's high point for these purposes was 8.6% in FY03. (Attachment A). As the chart below indicates, Brookline's reserves are currently budgeted in FY04 in an amount expected to be the equivalent of 7% of general fund revenue.

Town of Brookline Reserve Funds	FY2004
Appropriated Budget Reserve Fund (appropriated amount)	\$ 1,070,000
Non-appropriated Budget Reserve	\$ 714,316
Liability/Catastrophe Fund (year-end fund balance)	\$ 1,365,591
Capital Stabilization Fund (year-end fund balance)	\$ 4,182,026
Overlay Reserve (year-end fund balance)	\$ 4,139,038
Total Reserve Funds	\$ 11,470,971
Total General Fund Revenue	\$ 163,442,573
Total Reserve Funds as a Percentage of General Fund Revenue	7.0%

The most direct comparison that could be made to other Massachusetts municipalities was with the Town's annual budget reserve, which Brookline has most recently defined as an amount equal to 0.75% of prior year net revenue for an appropriated reserve and 0.5% from Free Cash as a non-appropriated emergency reserve. The average of these reserves in other Aaa communities for FY03 as a percentage of current year general fund revenues was 1.06%. The average for Brookline was 0.97%. (Attachment B).

While the overall level of reserves for Brookline has been reasonable, the Committee found itself concerned with two issues. First, the Town's reserve policies need to be modified to reflect changed conditions since they were adopted. In this regard, we are proposing that the budget reserve policy be adjusted moderately; guidelines be adopted for Overlay Surplus; and that allocations to the Post-Retirement Benefits Trust Fund be suspended.

Second, while the current policies were well structured to meet specific contingencies such as liability claims or extreme weather conditions, they do not allow for accessing reserves in the

case of a severe cyclical downturn or other extraordinary circumstance that adversely affects the operating budget. They also lack the flexibility of being able to shift resources from one purpose to another. This scenario posed a much more profound question for the Committee than simply adjusting existing policies. In response, we propose the introduction of a “rainy day fund” into the mix of Town reserves.

The experience over the prior thirty years has seen downturns occur in each of the past three decades. The Town was severely impacted in the years immediately following Proposition 2 ½, which was implemented in 1981 after a statewide ballot question. Then in the early 1990s it experienced a three-year period of contraction due to an economic decline. State and local governments are once again in one of these down cycles. State growth revenues declined 15% in FY03, cascading local aid cuts on cities and towns after several years of substantial increases, due primarily to Education Reform. Brookline’s aid from the state declined nearly \$3 million in FY04 from the levels received in FY02. Brookline’s long-range financial planning and utilization of specific cutback strategies for FY03 and FY04 enabled it to cope with the budget stress for those fiscal years.

However, suppose revenue shortfalls were even greater for FY04, or they were to persist to the point of outpacing even the most effective long-range planning or short-term budget tactics? If such conditions had occurred or were to develop, existing policies would not provide the flexibility for reserves to be used to help stabilize the operating budget. For many of the Committee members, this represented a “blind spot” in the policies.

To continue the full funding of reserves in periods of extreme budget stress strikes the Committee as questionable both as a matter of public policy and political acceptance. This is particularly problematic when the policies themselves allow no room to help relieve the stress in any way. In the alternative, the Committee fully subscribes to the concern that reserves must be treated with extreme restraint when used for “rainy day” purposes. Over-reliance on reserves to stem operating budget shortfalls can actually exacerbate a structural deficit over the long term. This is particularly so in the case of Massachusetts local government, where the primary source of revenue is the property tax, which is capped by Prop 2 1/2. Massachusetts state government can reasonably expect to see revenue expansion in up-cycles due to growth revenues like income and business taxes. Conversely, local government has no equivalent elasticity in its tax base and therefore needs to exercise considerable restraint in the use of reserves as a means of addressing a cyclical budget deficit.

Budget Reserve

The original budget reserve policy, which was adopted in 1995 and stemmed directly from the 1994 FPAC Report, called for setting aside an amount equal to 1.5% of the prior year's net revenue². One half of that amount (or 0.75% of the prior year's net revenue) would come from current year tax revenue as an appropriated budget reserve and another 0.75% would come from Free Cash as a non-appropriated emergency reserve. In FY2000, the Free Cash-funded portion of this policy was modified to allow for 0.5% of Free Cash to remain as a non-appropriated budget reserve and for the remaining 0.25% to be allocated to so-called strategic reserves such as the Liability/Catastrophe Fund and the Post-Retirement Benefits Trust Fund.

Since the policy for the appropriated budget reserve was established, an average of 70% of the fund has been expended annually over eight years. (Attachment C). In FY2001, virtually 100% of it was consumed. The Committee believes this experience more than justifies the need for an annual reserve of at least this level.

In contrast, in the life of the non-appropriated budget reserve, there has been no need to draw upon it. Granted there has not been another "Blizzard of 1978", but there were "100 year" rainstorms and other extreme events. The Committee does not see the need to continue a non-appropriated budget reserve in the range of 0.5% to 0.75%. Further, the Committee believes history clearly supports a reduction of the 1.5% overall annual reserve target.

**Town of Brookline
Percentage of Annual Appropriation Expended**

FY	Appropriated Budget Reserve	Non-appropriated Budget Reserve
1996	70%	0%
1997	41%	0%
1998	65%	0%
1999	87%	0%
2000	63%	0%
2001	100%	0%
2002	37%	0%
2003	83%	0%
Average	68.5%	0.0%

In the alternative, the Committee recommends the creation of a more straightforward and integrated operating reserve. This reserve, equivalent in total to 1% of prior year net revenue, would continue to be funded from two sources -- 0.75% appropriated from current revenue and 0.25% from non-appropriated Free Cash. Segmenting the funding sources in this way ensures stringent controls and continues to provide a Town Meeting check and balance when annual reserve expenditures reach extraordinary levels. It is important to note that any unexpended

² Prior year revenue is used as the benchmark throughout the fiscal policies because the Financial Plan preparations begin nearly a full year in advance. The prior year revenue is a much more certain base against which 1% can be applied. "Net revenue" continues to be defined as gross revenues, less: net debt exclusion funds, enterprise (self-supporting) operations funds, Free Cash, grants, transfers from other non-recurring non-general funds, and non-appropriated costs.

balance at the end of the fiscal year reverts back to the General Fund and is counted toward Free Cash. Simply put, this is a non-cumulative reserve fund.

It is essential that appropriations from both sources be treated according to the provisions of M.G.L. chapter 40, section 6, which allows for appropriations for extraordinary and unforeseen purposes only. The non-appropriated segment of this reserve must not be used for operating cyclical budget shortfalls or for what might be a popular service demand at a given time. It is intended as an integral component of the annual 1% budget reserve, requiring Town Meeting approval when more than three quarters of this annual budget reserve is used.

Stabilization Fund

A “Capital Stabilization Fund” was established upon the 1997 recommendation of the CIP Policy Review Committee, a study group appointed by the Board of Selectmen to review CIP Financing policies and practices. The first appropriation to the Capital Stabilization Fund was made in FY98 (Attachment D). The current policy is as follows:

“A capital stabilization fund, funded from Free Cash be maintained in an amount equal to 1% of the replacement value of the Town buildings (\$3 million in FY98). Said fund shall be used exclusively to fund, on a pay-as-you-go basis, capital projects when available Free Cash drops below \$2 million in any year. No more than \$1 million may be drawn down from the fund in any fiscal year.”

Review of the Fund immediately reveals two very significant facts concerning this reserve account. First, there have not been any disbursements from this Fund, which is not necessarily surprising given the expansionary period in which it was established. Second, however, the Fund has a balance nearly one-third greater than the target due to interest earnings and additional appropriations.

The status of this Fund presents a tremendous opportunity to bring about greater stability for the Town’s long-term budgetary position - not just for the CIP. As noted in our earlier comments, the Committee found policies lacking by not defining how reserves might be utilized in a disciplined fashion during periods of cyclical downturn as part of a comprehensive strategy to address budget shortfalls. Continued funding of reserves during times of budgetary stress could well erode support for funding the reserves themselves. Further, as one Committee member noted, if there were ever to be another Override attempt, taxpayers could appropriately question why they should be asked to pay more taxes when existing Town reserves had not been utilized to help address budget deficits.

Therefore, in what might be the Committee’s most far-reaching proposal, it is recommended that the Stabilization Fund be made accessible for both operating and capital needs when revenue conditions decline to specified levels. The Committee does not make this recommendation lightly, and urges that this overall “rainy day fund” be accessed only under the most stringent restrictions.

Use of this Fund for capital purposes remains virtually the same as set out in the initial policy. In addition, this Committee now proposes that the Fund be used for operating stabilization purposes when the increase of net revenue in the annual budget is less than 3%. In the last downturn of the early 1990s, revenue increased by less than 3% in three consecutive fiscal years. (Attachment E). Between FY95 and FY03 net revenue to the Town increased 5.5% on average. For the current Fiscal Year 04, with local aid cuts of nearly \$3 million, net revenue increased just 3%. If local aid cuts had been deeper, or some other revenue source lagged, then the Stabilization Fund could have been utilized.

It is critical from the Committee's perspective that utilization of the Stabilization Fund for the operating budget be linked specifically to revenue and not to overall budgetary shortfalls. Expenditures are deliberately left out of the formulation because they can be so sensitive to very localized issues that are unrelated to the regional economy or state fiscal conditions. The Fund may be drawn upon to make up for the revenue shortfall and get to a 3% increase. However, no more than \$1 million should be drawn down from the fund in any fiscal year, even if the amount needed to get to a 3% increase exceeds \$1 million. Lastly, use of the fund is capped at \$2.5 million over three consecutive years.

To accommodate the expansion of the Fund's purpose from just capital to the operating budget, the Committee also recommends changing the funding target itself. It is proposed that the target be 3% of prior year net revenue rather than 1% of the replacement value of buildings. For FY05, this would increase the fund balance from \$4.1 to \$4.4 million, requiring an appropriation into the Fund for the first time in three years. This increase should be achievable because of the proposed reduction in funding for the annual budget reserve.

Funding adjustments in future years under this revised target should be relatively modest, except to the extent that the Fund needs to be replenished after having been used for stabilizing budgets. The Committee believes that the replenishment of this Fund after use is essential, given the Fund's dual purposes for both operating and capital budgets. As such, the Stabilization Fund policy outlines a method of replenishing the fund following a drawdown.

The table on the following page illustrates an example of Stabilization Fund use and replenishment. In this scenario, the beginning Fund balance of \$4,182,026 is less than the Fund balance target (3% of the prior year net revenue). Therefore, an appropriation of \$246,892 is required in FY05 to reach the target level. At the same time, the scenario shows a \$2 million state aid cut, resulting in an increase in net revenue of less than 3% from FY04. Per the policy, this would trigger the potential for a drawdown from the Fund. The maximum drawdown would be \$872,547 (the amount required to restore a 3% increase in net revenue). The amount is also the minimum amount required for deposit into the Fund in FY06 in order to replenish it. (If possible, an additional \$106,691 would be deposited to get to the Fund balance target).

The FY06 scenario includes a state aid cut of \$1 million, for a net revenue increase of 2.5%, which would trigger a maximum potential drawdown of \$705,096. In FY07, that same amount would be deposited in the Fund to replenish it. (Again, if possible, an additional \$114,915 would be deposited to get to the Fund balance target). Since the FY07 scenario presents an increase in

net revenue of greater than 3%, no drawdown would be triggered.

Example of Stabilization Fund Use and Replenishment	FY05 BUDGET WITH A \$2M STATE AID CUT	FY06 BUDGET WITH A \$1M STATE AID CUT	FY07 BUDGET WITH NO STATE AID CUT
NET REVENUE	151,186,964	155,017,477	159,640,032
PERCENTAGE CHANGE	2.41%	2.53%	6.29%
WHAT A 3% REVENUE INCREASE WOULD EQUAL	152,059,511	155,722,573	154,705,626
AMT. NEEDED TO GET TO THE 3% REVENUE INCREASE (DRAW DOWN FROM FUND)	872,547	705,096	0
BEGINNING FUND BALANCE	4,182,026	3,556,370	3,830,513
APPROP. REQUIRED TO EQUAL PRIOR YR. DRAW DOWN		872,547	705,096
BEGINNING FUND BALANCE + "REPLENISHMENT"	4,182,026	4,428,918	4,535,609
ADD'L. APPROP. TO GET TO 3% FUND BALANCE TARGET	246,892	106,691	114,915
TOTAL FUND BALANCE PRIOR TO DRAW DOWN	4,428,918	4,535,609	4,650,524
DRAW DOWN	872,547	705,096	0
YEAR-END FUND BALANCE	3,556,370	3,830,513	4,650,524
TOTAL APPROP. INTO THE FUND REQUIRED TO GET TO 3% TARGET	246,892	979,238	820,011

Liability and Catastrophe Fund

Established by Chapter 66 of the Acts of 1998, and amended by Chapter 137 of the Acts of 2001, this Fund was created to protect the Town against major facility disasters or from the substantial negative impact of a lawsuit. (Attachment F). At the recommendation of the Board of Selectmen and Advisory Committee, Town Meeting acted favorably to adopt a home rule petition to allow the Town to establish this broad, comprehensive municipal insurance fund to cover both property and liability claims.

The initial appropriation made to this Fund in occurred in FY2000. Through FY04, it is anticipated that more than \$800,000 will have been disbursed from this Fund (Attachment G).

Given that the Town remains self-insured for liability purposes (tort claims, civil rights actions, etc.) and in light of the extent of the utilization of this Fund, no proposals are suggested to change this particular reserve account. However, the Committee does offer the following observations:

Prior to the establishment of the Fund, the Town had sometimes considered legal judgments and settlements as direct expenses to the operating budget. To the extent these items exceeded appropriations, they were absorbed in the subsequent year's tax levy. While this is a practice that is allowed by statute,

it is not one to which the Town should return given its total assumption of risk.

The Committee understands that a “risk mapping” study is underway under the direction of the Finance Director. The Committee commends this initiative and certainly encourages the Town to revisit this Fund if recommendations emerge from the study that warrant doing so.

Post-Retirement Benefits Trust Fund

In a strict sense, this Fund represents an attempt to set aside current resources for an unfunded future obligation, a concept analogous to making annual appropriations to the Retirement Fund. A critical distinction between the two, however, is that Retirement Fund obligations are prescribed by state statute (Attachment H). Funding for retiree group health benefits is purely discretionary. In fact, our survey information indicates that Brookline is one of only two municipalities in this state, and perhaps among the very few in the country, that has actually set aside funds for this purpose. Additionally, at our session with municipal finance experts, Mr. Shapiro suggested that the case for building a fund for post-retirement benefits is not as strong for government as it is in the private sector. He indicated that, while rating agencies take into account an unfunded pension liability while determining the fiscal stability of a community, they do not currently give equal weight to unfunded post-retirement benefits.

This Fund was adopted by Special Act 472 of the Acts of 1998 (Attachment I). The Board of Selectmen and Advisory Committee, upon the recommendation of Town Administration, urged Town Meeting to act favorably on this special act in response to the emerging national movement in municipal finance to address the growing spectra of unfunded post-retirement benefits obligations.

For nearly a decade, the Government Accounting Standards Board (GASB) has been suggesting that it would establish accounting requirements to report this obligation in financial statements. (Attachment J) Any GASB accounting requirement would cover financial reporting only. It would not address funding. In 1998, the Selectmen authorized the Finance Director to retain an actuary to ascertain the magnitude of the Town’s unfunded post retirement benefit obligation. At that time, it was projected to be \$94 million. The study was updated in 2001 and estimated the obligation at \$118 million. These estimates reflect the Town’s cumulative future obligation for funding health benefits for current employees after they retire.

In light of the environment of growing concern about this issue and in response to the actuarial reports, beginning in FY2000, Annual Financial Plans recommended allocations to this Fund. Through FY04 nearly \$3.7 million had been allocated to this fund. (Attachment K). The Funding sources for these appropriations have been Free Cash under the “strategic reserve” policy; reduction in the non-contributory retirement line item; overhead charges to non-general fund budgets; and unmatched funds from prior year health insurance appropriations.

**Town of Brookline
Post Retirement Benefits Trust Fund**

FY	Year-end Balance (cumulative)
2000	\$ 645,052
2001	\$ 1,290,098
2002	\$ 1,992,527
2003	\$ 2,632,481
2004	\$ 3,679,831

The Committee recognizes that the unfunded post-retirement benefits obligation is a major public policy issue. Post-retirement benefits are considered a key employment benefit for Massachusetts state and local governments and systemic strategies to address this matter must be devised. The Committee recommends continuation of the Fund at its current level and applauds the recognition of the Town and its employees of the severity and importance of this issue. However, the Committee can not recommend that the Town continue its ad hoc efforts to allocate funds for this purpose and urges that the Town refrain from future appropriations until conditions change. Principal considerations underlying this position are:

Despite setting aside more than \$3.6 million for the Fund, only a small proportion of the potential obligation has been satisfied. At this rate, the obligation would not be funded for more than a century.

The Town should reconsider allocating funds for this purpose when a statewide approach is developed that delineates obligations for all cities and towns.

After nearly a decade of discussion regarding potential accounting standards, GASB still has not promulgated accounting rules. Even when it does, the accounting guidelines will not dictate funding, simply reporting. Funding the liability is a matter of policy.

Most of all, the Committee could not justify voluntarily setting aside resources for such a long-term, outlying obligation, in the face of such immediate pressures on the operating budget. Communities across the country are struggling with group health costs that are far outpacing the growth in revenues. Brookline is facing double-digit increases in its group health budget for the third consecutive year. The Committee recommends that, at least for the immediate future, the current funding plan be suspended. The effect of this will be a reduction in the reimbursement for overhead costs for those non-general funds that support full-time employees, along with the freeing up of the resources associated with the reduction in the non-contributory retiree line-item.

The Post Retirement Benefits Trust Fund and its current balance should be maintained. If and when local governments across the board are required to establish a funding schedule for this

purpose, the Town of Brookline will have an important head start. Meanwhile, Brookline will continue to meet its obligation to retirees for health insurance on a pay-as-you go basis.

Overlay Reserve

The Overlay Reserve is an account established annually to fund anticipated property tax abatements and exemptions in that year. It is not established by the normal appropriation process, but rather is raised on the tax rate recapitulation sheet. Per the requirements of Massachusetts General Laws, the Overlay is established by the Board of Assessors. In the past, the Overlay has not been the subject of formal Town reserve policies. In fact, historically, the Overlay Reserve has been so outside the realm of traditional reserves that the Town Administration's initial summary of reserves for the Committee did not include the Overlay.

The historic separation of the Overlay from traditional reserve policy is understandable, due primarily to the facts that it is (a) established outside the normal appropriation process and (b) under the control of the Board of Assessors. In addition to establishing the amount of the Overlay, state statutes also vest in the Board of Assessors the power to declare when there is a surplus. The Overlay becomes further complicated because it entails more than just setting aside funds in one given year: individual yearly Overlay amounts become referred to as what is commonly known as "The" Overlay. Individual yearly abatements remain in existence because abatements can often take multiple years to work through the informal negotiation process and the formal Appellate Tax Board (ATB) proceedings. Further, although the Selectmen appoint the Assessors, state statute grants the Board of Assessors complete latitude in managing the Overlay process.

Nevertheless, the Committee considered this reserve to be squarely within the charge given by the Board of Selectmen. The Overlay is not a set aside for a long-term unfunded obligation like pensions, and statutory funding prescriptions are not as stringent as those governing the retirement system. In other words, the Town has more discretion with managing the Overlay Reserve on a year-to-year basis than it does with the Retirement Fund.

In addition, there are several, specific situational factors that warrant consideration of the Overlay in the overall context of Town reserves:

Demand has emerged recently in the City of Boston for using Overlay surpluses for recurring costs (union contract settlements) as a result of a recent statutory change lifting restrictions on Boston's Overlay funding that had existed for more than 20 years.

The total amount of Brookline's Overlay Reserves has grown to its highest level since at least the 1980s. (Attachment L)

The Board of Assessors sets the annual Overlay within expected norms at 2%-3%, including revaluation years. However, abatements for the past two years have been considerably lower than the average for the prior ten years. This has

contributed to the growth in the cumulative Overlay balance. Recognizing this, the Board of Assessors recently made a significant downward adjustment in its annual Overlay requirement for FY04. Nevertheless, the aggregate reserve is still at a level that arguably could warrant the declaration of a surplus by the Board of Assessors.

If the past is any guide to the future, it would seem that the Town's last experience in declaring an Overlay surplus in 2001 is indicative of some general practices that should be adopted. At that time, total Overlay Reserves for the years prior to 2001 was almost \$5.5 million. An Overlay surplus of \$2.7 million was declared and was appropriated by Town Meeting as part of the funding package for the Public Safety Headquarters renovation. According to the Chief Assessor, this left an adequate Overlay Reserve to cover possible exposure from prior outstanding abatement claims and from "expungement" cases.

Recognizing the independent authority legally vested in the Board of Assessors, the Committee recommends a process for the Selectmen to follow to identify Overlay surpluses and for the use of Overlay surpluses once declared. The Committee recommends that the Selectmen require an annual report from the Assessors at the close of each fiscal year. If potential surpluses are identified in this fashion, the Selectmen can then request a declaration of surplus, which would be applied to the CIP or other one-time expenses. For the first year implementation of this policy in FY2005, it is expected that any Board of Selectmen request for Overlay Surplus shall not reduce total Overlay reserves to less than \$3 million.

Free Cash

Free Cash is the amount of funds in a community that are unrestricted and available for appropriation at the end of a fiscal year. The amount of Free Cash available to a community is certified annually by the Director of Accounts at the Department of Revenue's Division of Local Services. The Town's policies governing the use of Free Cash were set forth in a set of Financial Management Policies adopted by the Board of Selectmen in 1994. Generally, those policies restricted the use of Free Cash to the funding of reserves and to supporting the CIP. Over time, additional one-time (non-recurring) purposes were established for which Free Cash would be allocated, such as support for the Affordable Housing Trust Fund.

The Committee's recommendations concerning Free Cash basically continue these purposes, except as modified in the proposed Reserve Policies. However, consistent with the Committee's objective to simplify fiscal policies in order to make them more easily understood, the proposed Free Cash Policies are presented in an integrated one-page format.

In effect, the Committee came to understand the Free Cash Policies as a sequencing of decisions based upon priorities embedded in the Policies. The following chart illustrates the order of priority:

FREE CASH SEQUENCE			
USE	CURRENT POLICY	RECOMMENDED POLICY	USED YEARLY?
Non-Appropriated Budget Reserve	0.5% Prior Year Net Revenue	0.25% Prior Year Net Revenue	Y
Stabilization Fund	1% of value of Town facilities (for capital budget use only)	3% Prior Year Net Revenue (for capital and operating budget use)	Y
Liability/Catastrophe Fund	1% Prior Year Net Revenue	1% Prior Year Net Revenue	Y
CIP	All remaining Funds, except for provisions as listed below.	All remaining Funds, except for provisions as listed below.	Y
Affordable Housing Trust Fund	When Free Cash exceeds \$6 million, 5% allocated	When Free Cash exceeds \$6 million, 5% of Free Cash allocated	N
	When Free Cash exceeds \$7.5 million, 7.5% allocated	When Free Cash exceeds \$7.5 million, 7.5% of Free Cash allocated	
	When Free Cash exceeds \$10 million, 10% allocated	When Free Cash exceeds \$10 million, 10% of Free Cash allocated	
Special Use	0.25% Prior Year Net Revenue	In the event that the above provisions are met, Free Cash may be used to augment other reserves/trust funds, such as Workers' Comp.	N

The above chart indicates the first priority use of Free Cash is to fund the Annual Non-Appropriated Budget Reserve, the Stabilization Fund, the Liability/Catastrophe Fund, and the CIP, in that order; then the Affordable Housing Trust Fund (if Free Cash exceeds \$6 million); and finally, other special non-recurring uses. The Committee strongly believes that allocations

to the Special Use category should be made only as Free Cash allows. These allocations will be subject to the Town's standard approval process, beginning with the recommendation by the Town Administrator and the approvals of the Board of Selectmen, Advisory Committee, and Town Meeting.

As was the case with the initial policies adopted in 1994, the volatile and unpredictable nature of Free Cash is reflected in these policies. The Town's Free Cash experience has varied widely over the past 15 years. There is every reason to anticipate wide swings will continue in the future (Attachment M).

As a final definitional note, Free Cash is not an easy concept to understand. As a former Commissioner of the State Department of Revenue once said, "It is neither, 'free' nor 'cash'." In addition, while there can be much debate over whether Free Cash is "one time" or not "one time" revenue, it is without question the most unstable and unpredictable revenue source to the Town. Even local aid, with all of its political variability, has not swung to the extremes exhibited by Free Cash. Accordingly, the Committee has quite deliberately recommended that Free Cash be utilized in ways that avoid it being used to support recurring expenditures that support direct services.

Capital Improvements Program (CIP)

A Capital Improvement Program (CIP) is a long-range spending plan that determines and prioritizes a community's capital needs within its financial constraints; it represents a commitment to investment in infrastructure and the maintenance of assets. A well-formulated CIP has numerous benefits, including enhancing and/or maintaining a community's credit rating, stabilizing its tax rate, identifying non-tax revenue sources (grants), controlling debt, and keeping the capital needs of a community in the forefront.

A well-planned CIP, integrated into the annual budget process, helps maintain a consistent minimum level of spending for capital projects. Experience shows that in tight fiscal years, municipalities often defer or eliminate capital spending as a way to resolve a projected operating deficit. The passage of Proposition 2 ½ in the early-1980s and the poor economic climate of the early-1990s forced many communities, including Brookline, to delay much-needed capital improvements.

Brookline's CIP Process

The preparation of the annual CIP is mandated by statute: MGL Chapter 41 provides that the Planning Board shall prepare and submit annually a CIP for the Town. Chapter 270 of the Acts of 1985 (special legislation known as the "Town Administrator Act") directs the Town Administrator to prepare and recommend an annual financial plan, which includes a CIP. The annual process for Brookline begins with the submission of project requests by departments, which in many cases are the result of various board/commission (Park and Recreation Commission, Library Trustees, etc) public hearings on capital projects. The requests are then reviewed by a committee that is co-chaired by the Deputy Town Administrator and the Director of the Department of Planning and Community Development and is comprised of all department heads that have requested projects. After reviewing all project requests, the committee approves a preliminary CIP that is presented to the Town Administrator and the Planning Board.

The Planning Board holds hearings at which all projects included in the preliminary CIP are reviewed. Simultaneous with that review, the Town Administrator presents the preliminary CIP to the Board of Selectmen after a public hearing has been held on the ensuing year's overall financial plan (operating and capital budgets). All comments, recommendations, and suggestions from the public hearing, the Board of Selectmen, and the Planning Board are taken into consideration and factored into the formal CIP proposed as part of the Financial Plan that is presented in mid-February. At that point, the Advisory Committee holds public hearings on the CIP and makes its recommendations. The Planning Board's final recommendations are published in an annual CIP booklet prepared and distributed prior to the Annual Town Meeting. Town Meeting then takes action on the projects included in the first year of the CIP as part of its budget vote.

FPRC Review

The Committee reviewed each of the current CIP policies along with aggregate capital expenditures spanning the past decade. The Committee found that Brookline's CIP Policies are sound and are consistent with financial best practices. Brookline's CIP Policies include: the key financing provision that an amount equal to 5.5% of the prior year's net revenue is dedicated to the CIP; definitions of capital improvement projects and how projects are evaluated and prioritized; and debt management policies including per capita maximums and debt maturity schedules. Several other Aaa communities surveyed have no formal CIP policies or have adopted policies but have not followed them.

The Committee reviewed Brookline's capital spending relative to comparable communities. The Committee found that Brookline is within the norm of comparable communities with regard to the Town's debt burden. (Attachment N). The following table indicates where Brookline ranks both within the group of the 12 Aaa-rated communities in Massachusetts and all communities in the Commonwealth:

Variable	Brookline	Aaa Rank	State Rank
FY02 DEBT PER CAPITA	\$1,689	6	105
FY02 DEBT AS A % OF EQUALIZED VALUATION	99%	6	181
FY02 DEBT PER CAPITA AS A % OF PER CAPITA INCOME	3.8%	6	176
FY02 GENERAL FUND DEBT SERVICE PER CAPITA	\$223	5	77
FY02 DEBT SERVICE AS A % SPENDING	8.5%	4	112
FY02 TOTAL DEBT SERVICE PER CAPITA	\$223	6	104

The Committee's overall evaluation of the Town's CIP policies is positive and only minor changes are recommended. There were some issues, however. While the Committee understands and appreciates the fact that the CIP is, and must be, based on the availability of funds, some members expressed concerns with 1.) the annual process of preparing the CIP and 2.) the adequacy of funding levels compared to the on-going need for capital improvements throughout the Town. More specifically, the following observations were made:

1. The development of Brookline's CIP is not "from the ground-up". Absent is an ongoing, comprehensive needs assessment that takes into account the functional life of facilities upon which a replacement schedule is built. Ideally, a capital plan includes the renovation / rehabilitation of a major facility every "x" number of years. In Brookline's case, a major facility project is scheduled in sequence based upon availability of funds.

While this is a concern, the Town has done a commendable job of prioritizing and funding major capital projects that have prolonged the functional life of capital assets; maintained and/or made better use of existing facilities; and eliminated proven hazards to public health or public safety. The data provided to the Committee, which is presented below, illustrates that over the past decade, more than \$190 million has been authorized

for work on major or new facilities and for infrastructure. This translates into approximately 90% of all authorizations being spent on the physical plant, exactly what one would expect from a well-formulated CIP. (Attachment O).

CATEGORY	10-YR TOTAL	% OF TOTAL	ANNUAL AVERAGE
NEW FACILITY	\$11,250,000	5.3%	\$1,125,000
MAJOR FACILITY	\$117,362,000	55.4%	\$11,736,200
MINOR FACILITY	\$5,900,000	2.8%	\$590,000
FACIL. RELATED	\$8,789,300	4.2%	\$878,930
PARKS/OPEN SPACE	\$12,798,500	6.0%	\$1,279,850
INFRASTRUCTURE	\$47,762,264	22.6%	\$4,776,226
VEHICLES	\$2,829,000	1.3%	\$282,900
MISC. - MEDIUM	\$4,501,400	2.1%	\$450,140
MISC. - MINOR	\$597,000	0.3%	\$59,700
Grand Total	\$211,789,464		\$21,178,946

Examples of some major projects include the following:

School Buildings - Baker School, Heath School, High School, Lawrence School, and New Lincoln School.

Municipal Facilities - Municipal Service Center, the Public Safety Headquarters, Main Library Restoration, and the Senior Center.

- Is the 5.5% of the prior year's net revenue, plus free cash, adequate to fund the Town's capital needs? It was pointed out to the Committee that the current CIP process showed the 6-year need to be \$83.18 million, as expressed by requests from Department Heads. Compared to the level of estimated available funding of \$72.62 million, it is clear that requested funding exceeds available resources. If Free Cash drops below projected levels, the gap could be even greater, perhaps significantly so.

In addition to understanding that the CIP is based on the availability of funds, the Committee also understands that for every action there is a reaction, and increasing the 5.5% target funding for the CIP would impact the level of funds available for the operating budget.

Understanding these constraints, coupled with the obvious fact that an unprecedented level of capital improvement has been accomplished since the policies were first adopted (\$204.38 million in total authorizations since FY96), the Committee recommends no change to the primary policy that an amount equivalent to 5.5% of the prior year's net revenue, plus free cash

that remains after fulfilling reserve requirements, be committed to the CIP.

Recommendations

As stated above, the Committee is not recommending any changes in terms of funding levels for the CIP. We are, however, making the following recommendations:

Definitions

Since the current CIP policies were developed nearly a decade ago, and most recently reviewed seven years ago, the definition of a CIP project needs to be updated. The current threshold of \$10,000 should be increased to \$25,000.

Debt Management Policies

The 1997 Committee that reviewed the CIP policies recommended that new School Building Assistance Bureau (SBAB) reimbursements be added to the 5.5% / free cash funding package. This Committee recommends eliminating that provision, which has not been incorporated into practice. The SBAB reimbursement that comes to the Town from the State should go toward paying for the debt service associated with the school project; adding it on top of the existing funding mix is unnecessary. In effect, this policy, if followed, would divert funding to the CIP that otherwise is used in the operating budget for debt service.

Another recommendation is to index to inflation the policy that states total outstanding general obligation debt per capita shall not exceed \$2,000. The \$2,000 figure was established in 1997. Since then, the effect of inflation has effectively decreased that figure to approximately \$1,700. The Committee recommends that, beginning July 1, 2004, the maximum outstanding general obligation debt per capita figure be adjusted annually by inflation, as measured by the consumer price index (CPI) for all urban consumers (northeast region, all items).

Technology

The final capital financing issue the Committee reviewed was how technology fits into a CIP. Both public and private organizations are struggling to determine the most appropriate way to budget for technology expenses. Historically, technology purchases were large, one-time expenses and the equipment lasted for many years, making them appropriate capital expenses. Today, however, many of the costs associated with technology have decreased, and as the expected lifespan on some technologies has decreased, it is less clear whether these items should be considered as capital or operating expenses.

Staff research showed that current practices of budgeting for technology vary by organization. Some organizations use a dollar threshold, while others use a measure of useful life. The State uses both bond-funded appropriations and operating budget funds to procure technology. Since there is no industry standard, the Committee recommends following a hybrid approach:

Purchase/lease of individual computers, mobile devices such as personal digital assistance (PDAs), and stand-alone software are operating expenses and should be addressed within the operating budget

Purchase of enterprise-wide technology such as infrastructure and cross-department applications and certain major department-specific applications (e.g., assessing system, school pupil data management) are considered a capital asset and may be addressed within the capital budget

The Committee recommends the continuation of the Interdepartmental IT Committee. This committee, which evaluates and prioritizes Town and School technology needs, includes representatives from all major users of technology. The committee provides a comprehensive planning and review process of IT needs and, where possible, enables the Town to leverage the combined buying power of both the Town and School. The Committee also commends the work of the Information Technology Advisory Group (ITAC), a group of citizens with expertise in the IT field. Their review of budget requests is most helpful and should continue.

As stated above, there is precedent at the state level for using capital funds for technology. Most of the state's bond-funded appropriations for technology are used in extreme situations where the initial expenditure for non enterprise-wide technology would be disproportionate to the size of the current operating budget. In these instances, use of capital funds may be appropriate for initial outlays or investments in technology, provided that the future annual replacement costs are absorbed by the operating budget.

A concerted effort is being made to change the student to computer ratio in the Brookline Public School System. Currently, through operating funds, the schools are maintaining a student to computer ratio of 4 to 1 (6,000 students for 1,500 computers). A needs study is underway, which could recommend an increased number of classroom computers.

A significant increase might place an undue burden on the schools operating budget. In the alternative, the Town could consider capital funding to support the initial four-year life cycle, including maintenance, for the additional computers with the understanding that the schools will place the future, annual replacement cost in their operating budget at the end of the four-year life cycle.